

# **WHEN YOU OWE TAXES AND CAN'T PAY**

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It will soon be tax time once again. For most of us, it's an unpleasant but necessary duty. Still for others, it is just one more part of an ongoing nightmare. Unfortunately, there are many members of our military family who owe the IRS. Some have not filed tax returns in many years and fear that filing these delinquent returns will expose them to criminal prosecution, jail time, and the tax collector. The stress can be unbearable. I'm here to tell you that there are steps that you can take right now to relieve and even eliminate these burdens.

For the service person who is currently activated and will soon be sent "over there", there are laws on the books that will keep the tax collector away from you while you are on active duty and for a short time after you return. While these laws are helpful, they only defer the problem and do not eliminate it. In this article, I want to talk to you about eliminating the problem and not simply putting it on the back burner, so to speak.

## **I Have Not Filed My Tax Returns – What Should I Do?**

Prepare and file all delinquent tax returns, state and federal. This is required by law, pure and simple. You want to file your delinquent returns because filing starts the statute of limitations for both audit and the collection of taxes. If you never filed returns, no statute of limitations runs. If your plan is to get out of paying income taxes by filing a Chapter 7 in bankruptcy, you cannot get a discharge on any tax years in which tax returns have not been filed. I'll discuss this later.

Most criminal prosecutions for tax fraud or failure to file tax returns originate because the tax man contacts the taxpayer before he or she begins the process of preparing delinquent returns. It is very rare that the IRS will prosecute anyone who is in the process of having his or her delinquent returns prepared at the time the investigator knocks on the door. So, if you have not filed your returns, your first step is to retain a tax return preparer and make a good start.

When you file your delinquent tax returns and you owe the IRS, there will be delinquency penalties and interest on any amount of tax that is owing and unpaid. Sometimes these penalties and interest can be abated for reasonable cause such as a fire, flood, death or serious illness in the family.

If you can pay your delinquent taxes, interest and penalties in full, you should do so as soon as possible. Do not wait for collection notices to be sent to you as interest continues to accrue and is compounded daily. But, what happens if you file your delinquent tax returns, owe taxes and cannot pay in full? This is what we will discuss next.

### **I Owe, I Owe. Is It Off to Jail I Go?**

Relax. The IRS usually does not criminally prosecute people who have filed returns and just owe taxes. There are criminal statutes on the books but they are not enforced. The IRS wants you back on their system and they are willing to work with you providing you approach them in good faith. As far as the IRS is concerned, it is more important that you keep current on your present tax compliance than it is that you pay old tax bills. People who owe taxes and cannot pay have basically four options. We will discuss each option now.

**Option 1: Hardship Suspension.** If you cannot pay your delinquent taxes because you do not have the cash flow, you can ask that collection efforts be suspended due to economic or some other hardship. You must complete the appropriate IRS financial statement and supply

back-up documentation as required such as past bank statements and paycheck stubs in order to prove the hardship. Hardship does not mean forgiveness of your tax bill. It means that your obligation will be deferred. If the IRS agrees to suspend collection, interest will accrue on a daily basis. In this respect, the principle is the same as non-payment of a commercial obligation. In about a year or so after granting hardship suspension, your file will be reviewed and you will be contacted to update your financial condition so the IRS can determine whether to continue the hardship suspension. While your case is under suspension, the IRS will not engage in any enforced collection activity such as a bank account levy or wage garnishment.

If you are called to active duty overseas, the IRS is prohibited from collecting any delinquent taxes during the period of activation and for several months after you return. Interest continues to accrue. It's a deferral and not a forgiveness.

**Option 2: Installment Payment Arrangement.** Here you negotiate a monthly written installment payment plan with the tax man. You submit a financial statement with the appropriate supporting documentation such as several months of current bank statements, paycheck stubs and copies of various bills. You will then negotiate a monthly payment plan with the IRS. Ideally, either government wants you to pay what you owe within three years. Interest continues to accrue and is compounded daily on the unpaid balance of taxes, penalties and interest. While you are making payments, the tax man will not engage in enforced collection such as a bank account levy or a wage garnishment.

**Option 3: Offer in Compromise.** There has been a lot of hype over the radio, on television and in the newspapers about making deals with the IRS for ten cents on the dollar. These folks make it all sound like a slam dunk, but it isn't. The IRS is smart and savvy and they just don't roll over. Don't believe the hype! Under certain circumstances, it is possible for a

taxpayer to compromise or settle a deficiency or a dispute with the IRS by offering to pay a smaller sum as payment in full, even though a larger sum may be owed. This is the essence of most offers in compromise. If the offer is accepted, tax liens will be removed and enforced collection, with all of its stress, will be avoided.

Offers in compromise can take up to two years to complete, but the IRS is not giving away the store. There are signs from on high that the IRS is tightening up on the acceptance of offers in compromise. Before you can be eligible to submit an offer in compromise, you must be current on your filing and obligations to pay your taxes. If the IRS does grant you a deal, you will be effectively put on a five-year probation. This means that within five years after your offer is accepted, you must not be late on filing your income tax returns or paying your taxes for the current year.

Offers in compromise are technical and require specialists to present, negotiate and sometimes appeal a rejected offer. Not everyone will qualify for an offer in compromise. You should retain a specialist to represent you.

**Option 4: Bankruptcy.** Yes, certain taxes can be discharged in a bankruptcy proceeding. Most state and federal income taxes can be discharged in a Chapter 7 and many penalties and other assessments can be discharged through a Chapter 13 payment arrangement. Great care must be exercised in choosing a lawyer to represent you in Bankruptcy Court. There are a lot of bankruptcy lawyers out there but very few understand the ins and outs of procedures relating to the discharge of tax liabilities. You cannot receive a discharge for a tax year in which you have not filed a return. To me, bankruptcy discharge rules are similar to preparing a great tasting stew. You have to have the right type of tax (the right ingredients); the passage of the right amount of time (letting the stew cook); and a savvy bankruptcy lawyer (an experienced

chef). All of these ingredients have got to be blended together in order for you to obtain what you want out of your bankruptcy proceeding.

### **Summary**

If you have not filed tax returns, you should get started by retaining a tax return preparer before the IRS contacts you about the returns. If you owe taxes and can't pay, there are several avenues open to you ranging from hardship suspension to an offer in compromise, to an eventual discharge in bankruptcy. The key to it all is your being proactive. Procrastination could mean headaches that could have been avoided.

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